MINUTES
of the
FIFTH MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

October 13-14, 2015
State Capitol, Room 322
Santa Fe

The fifth meeting of the Revenue Stabilization and Tax Policy Committee was called to order by Senator Carlos R. Cisneros, chair, on Tuesday, October 13, 2015, at 10:05 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Jason C. Harper, Vice Chair
Sen. Ted Barela
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. Mark Moores
Sen. George K. Munoz (10/13)
Rep. Debbie A. Rodella (10/13)
Sen. Clemente Sanchez (10/13)
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Carl Trujillo
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Sen. Sue Wilson Beffort
Rep. David M. Gallegos
Rep. Tim D. Lewis

Designees
Sen. William F. Burt
Rep. Conrad James
Rep. Bill McCamley
Sen. Nancy Rodriguez (10/14)

Rep. David E. Adkins
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Sen. Lee S. Cotter
Rep. Randal S. Crowder
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Rep. Bealquin Bill Gomez
Sen. Stuart Ingle
Sen. Gay G. Kernan
Rep. Stephanie Maez

Rep. Javier Martínez
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

(Attendance dates are noted for members not present for the entire meeting.)

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Tessa Ryan, Staff Attorney, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Rebecca Griego, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Tuesday, October 13

National Perspectives on the Gross Receipts Tax
Matthew Gardner, executive director, Institution on Taxation and Economic Policy (ITEP), explained that the ITEP is a nonprofit think tank that analyzes tax policy issues and is based in Washington, D.C. The ITEP has developed a microsimulation model that uses a large sample of tax returns and other data to examine taxes paid under current laws and various proposed alternatives to current laws. This model has the capacity to examine various data from all 50 states.

Mr. Gardner discussed a number of tax principles that might be considered when examining options for tax reform. He stated adequacy, sustainability, simplicity or transparency and competitiveness as principles that should be considered in addition to fairness. He also discussed the principle of neutrality, which requires that tax systems refrain from choosing winners and losers.

Mr. Gardner presented a chart showing the state and local taxes paid, as a percentage of income, by taxpayers within various income levels in New Mexico. He pointed out that the chart shows that low- and middle-income taxpayers pay higher percentages of their incomes on taxes than upper-income taxpayers. He noted that New Mexico's tax structure ranks as the seventeenth most regressive system in the country and that the regressive pattern is the result of how personal income taxes, corporate income taxes, sales taxes and excise taxes are imposed and paid. States with the most regressive tax structures typically do not rely heavily on income taxes; rather, those states rely more heavily on sales, excise and gross receipts taxes.

With respect to the imposition of broad-based consumption taxes, Mr. Gardner said that 45 states, including New Mexico, have a broad-based consumption tax that applies to most retail consumption, while exempting most business inputs. He indicated that a few states, including Delaware and Washington, have taxes that are considered as gross receipts taxes, rather than traditional sales taxes. He mentioned that New Mexico is sometimes considered as part of this list, but New Mexico is most often considered to have a hybrid sales and gross receipts tax system.

Some possible issues associated with consumption taxes are that they are regressive, and low-income credits intended to offset those taxes often do not provide a complete remedy. Also, consumption taxes often do not provide for full taxation of consumer sales or adequately exempt business inputs. New Mexico, unlike other states, has taken steps to provide for full taxation of consumer sales by taxing services.

Mr. Gardner stated that in theory, an ideal gross receipts tax would apply a low tax rate to the value of business receipts from the sale of goods and services and no deductions would be provided for costs incurred by sellers. A low tax rate would be an important component of such a system because of pyramiding concerns. However, in practice, some states apply different rates to different activities, while others exempt some business inputs or impose high tax rates. Yet, Mr. Gardner noted that most traditional sales taxes imposed in other states also fall short of an ideal system.

Options for tax reform could include providing for a structure that is more similar to a pure gross receipts tax or a pure sales tax structure. Under either approach, it must be determined whether tax reform should, on its own, raise new revenue or be revenue-neutral. Impacts on local governments and possible changes to low-income tax credits should also be considered.

Mr. Gardner stated that some states are considering implementing gross receipts taxes as a replacement for corporate taxes. For example, Ohio repealed its corporate income tax and replaced it with a commercial activity tax. Other states, such as Delaware, have implemented a gross receipts tax as an alternative to a sales tax.

Joseph D. Henchman, vice president of legal and state projects, Tax Foundation, commended the committee members for exploring the topic of tax reform and mentioned that a recent survey of businesses nationwide indicated that taxes are the main factor that businesses consider when locating to various states. Some states, such as North Carolina and New York, have recently implemented major tax reforms, and many other states are contemplating how their tax systems fit into a competitive environment.

Mr. Henchman stated that nationally, there is not a consensus on whether a gross receipts tax constitutes a business tax or a consumption tax. In Ohio, the gross receipts tax is based on a percentage of the amounts collected by businesses. In New Mexico, the gross receipts tax is based on business activity, and a percentage of business sales is taxed. New Mexico's gross receipts tax closely resembles a sales tax, in part, because of its broad base. He contrasted New Mexico's gross receipts tax with Ohio's gross receipts tax, which he indicated operates more like a business tax.

Mr. Henchman also discussed the tax structures and contemplated reforms of various states. Texas recently reduced its corporate income tax rate, while Washington is contemplating whether to base its tax structure on a gross receipts tax or an income tax. Nevada recently enacted a modified gross receipts tax, which provides for varying rates for different industries.

Mr. Henchman said that an ideal tax base is one that includes a tax on all final purchases of goods and services, but does not include a tax on business inputs. He said there are no states that have achieved this ideal. All states tax business inputs or exempt from taxation some elements of final purchases of goods and services. He mentioned that New Mexico provides a deduction on sales of food from gross receipts, while other states exempt transactions on clothing or prescription drugs. While there might be policy reasons for such deductions or exemptions, they depart from a traditional tax base.

Elaborating on the characteristics of New Mexico's gross receipts tax, Mr. Henchman said that a number of business inputs are taxed, while consumption is exempted at various levels. As was mentioned by Mr. Gardner, Mr. Henchman explained that New Mexico may be ahead of other states in that it taxes services, broadening the base of the tax. Since the national economy is becoming more service-oriented, other states are examining the possibility of imposing a tax on services, as well as goods.

In regard to tax reform, Mr. Henchman suggested that any strategy should first focus on what objective is sought to be achieved. Tax principles such as transparency, stability and fairness could provide some guidance in crafting tax reform strategies.

Mr. Henchman discussed a recent study performed by the Tax Foundation that compares the tax systems of each state through the viewpoint of hypothetical businesses in seven different industry sectors. The study showed that New Mexico falls within the average of taxes imposed on businesses. When considering tax reform options, it might be useful to consider whether it is most prudent for New Mexico to seek to attract all businesses or certain businesses that fit New Mexico's economic profile. He suggested that the state's strengths and shortcomings should be considered in an evaluation of its tax system.

Questions and comments from the committee members followed. A committee member discussed possible strategies to reform the state's gross receipts tax system, including the imposition of a broad-based gross receipts tax with a low rate and an examination of existing exemptions, deductions and credits. The committee member mentioned that it might be a challenge to determine whether such reform might yield the revenue necessary to provide for a balanced budget.

Another committee member highlighted a number of tax advantages available in New Mexico relative to other states, including that New Mexico has the eighth-lowest property tax rate in the country, has a low corporate income tax rate and a competitive personal income tax rate. The committee member expressed a desire to make the gross receipts tax system more transparent.

In response to a question from a committee member, Mr. Gardner noted that New Mexico's income tax structure might have a relatively greater impact on taxpayers with lower incomes even if many corporate income taxpayers are located out of state. He said that on some level, many corporate income taxes might eventually be shifted to wage earners. He also said that property owners might eventually shift the burden of some property taxes to property renters. In response to a question from a committee member, Mr. Gardner stated that a chart showing the overall tax incidence of all New Mexico's major tax programs could be produced.

A committee member asked how gross receipts deductions for food and medical services might be viewed in terms of certain principles such as tax fairness or how those deductions would be viewed relative to a system that includes a pure sales tax. In response, Mr. Henchman stated that some states provide for tax exemptions for unprepared food, but impose taxes on transactions involving prepared food. While some of those states might have meant to provide tax relief to low-income individuals, the taxation of prepared food still had an effect on those individuals. Other states have adopted more targeted programs where rebates are provided to individuals with incomes below certain levels. Mr. Gardner said that states have not yet expanded tax rebates for low-income individuals in a manner that completely offsets the impact of taxes on groceries. Trends show that states are increasingly exempting transactions on groceries from taxation, but taxes on other items might increase.

In response to a question from a committee member about what might constitute a pure sales tax, it was Mr. Henchman's opinion that an ideal tax base would include minimized business input taxes and continued taxation of services. Tax expenditure reports illustrate that what states do not tax can have as much of an impact on policy as what is taxed. For example, in Nebraska, there were efforts to eliminate all tax expenditures, and most of those expenditures involved business inputs in the agricultural industry. He said there are some deductions, credits or exemptions that address structural issues and might be enacted to mitigate pyramiding or eliminate taxation on certain transactions for constitutional reasons. Some tax expenditures involve economic development incentives that are intended to attract certain industries, and some involve policy initiatives and might include deductions for transactions on groceries or other transactions.

A committee member asked how other states approach taxation of donations to or transactions by nonprofit organizations. Mr. Henchman stated that some states provide exemptions or deductions for nonprofit organizations based upon whether those transactions are essential to the missions of those organizations, but other states do not.

A committee member asked for clarification of the difference between a pure gross receipts tax and a pure sales tax. Mr. Henchman explained that a pure gross receipts tax provides for an imposition of a uniform tax rate on all transactions, and pyramiding is a characteristic of that type of system. A pure sales tax includes a tax on all final purchases of goods and services, without the imposition of a tax on business inputs. In response to another question, Mr. Henchman stated that the incidence of the sales tax does not necessarily determine whether the tax constitutes a pure sales tax or a pure gross receipts tax since, ultimately, practical tax burdens are shifted by businesses to consumers, by employers to employees and by corporations to shareholders. New Mexico's tax system is a hybrid between a gross receipts tax and a sales tax system, but has more of the characteristics of a sales tax system due to the deductions to address pyramiding.

A committee member asked how a tax system could be fashioned to provide for adequate revenue while encouraging economic development. Mr. Gardner responded that while there might be various conflicting objectives within state tax systems, states can analyze tax reforms using the basic principles that underlie various tax structures and study existing distortions in their tax structures. He also said that states can use tax expenditure reports to examine why certain tax incentives are included in their tax codes and whether those incentives help eliminate pyramiding or achieve some desirable social objective. He added that states should take into account their own unique features when considering options for tax reform.

A committee member expressed concerns with New Mexico's existing tax structure and that some of the state's tax laws do not promote fairness or simplicity. He said the state needs a tax system that better fosters economic development, while promoting fairness and providing revenue neutrality. The committee member indicated that a broad-based gross receipts tax with a low rate could include a pyramiding aspect but indicated that a low rate could mitigate any impacts on business inputs. The committee member also mentioned that a simpler tax system could encourage better compliance with state tax laws.

Mr. Gardner responded that if a low rate is achieved, political decisions can still enter into a tax system. In that case, there might be some deductions or exemptions that would continue to exist, and it might be necessary to examine the effects on existing tax rates. Mr. Henchman added that while a pure gross receipts tax might have a lower rate than other taxes, its effective rate might be higher than that of other taxes as a result of pyramiding. Some industries would be more impacted than others, but vertical integration of industries could help mitigate the impact. He also said that some taxes provide a greater impact on economic growth than others. For instance, property taxes have the lowest impacts on economic growth, while taxes with high effective rates might have the most significant effects.

A committee member asked what types of strategies might mitigate the impact of a broader, flatter gross receipts tax on low-income individuals. Mr. Gardner suggested that increasing the impact of mechanisms such as the low-income comprehensive tax rebate might achieve that goal. He indicated that some states, such as Vermont, have explored the possibility of providing "pre-bates", instead of rebates, to offset certain tax liabilities.

A committee member asked whether other states have benefited from having a number of exemptions or deductions in their tax codes for varying purposes. Mr. Henchman responded that in the 1970s and 1990s, Michigan used some targeted tax incentives to benefit the automotive industry, but eventually those incentives became less effective and Michigan implemented a more broad-based tax. Mr. Gardner added that some states have become susceptible to providing tax incentives for various reasons, and it is possible for large numbers of incentives to drive tax rates up and narrow the tax base.

A committee member asked whether there might be a mechanism to tax internet sales transactions in the future. Mr. Henchman explained that federal laws would need to be changed to permit states to address this issue. Another committee member asked if there had been any lessons learned from successful tax reform attempts. Mr. Gardner stated that the most successful reforms have been viewed as principled, fair and even-handed.

A committee member noted that New Mexico's population is declining and New Mexico's rate of recovery after the recession lags behind the recovery rates in the rest of the country. The committee member noted that a study of New Mexico's tax system might provide some insight on possible reforms.

A committee member expressed concern about the ability to raise the necessary revenues while trying to reduce tax burdens. Mr. Gardner responded that states must consider spending levels when reducing taxes.

Committee members, Mr. Gardner and Mr. Henchman discussed the importance of the concept of fairness in tax reform efforts and how perceptions of tax fairness can widely vary. A committee member commented that certain circumstances, such as a changing economy, can motivate tax reform. The committee member opined that a competitive, adequate and stable tax system should be a goal and that without stability and adequacy, underground economies could emerge.

Local Option Gross Receipts Tax Distribution Adjustments — Status After the New Mexico Supreme Court's Action in *City of Eunice v. State of New Mexico Taxation and Revenue Department*

Demesia Padilla, secretary, Taxation and Revenue Department (TRD), provided the committee with an update on the status of local option gross receipts tax distribution adjustments. She explained that the City of Eunice filed a lawsuit against the TRD as the result of negative distributions of local option gross receipts taxes for which the TRD sought collection.

Negative distributions might occur when taxpayers request refunds of local gross receipts taxes already distributed to local governments. The New Mexico Court of Appeals upheld a district court decision to limit the TRD's recoupment of payments of taxes that were distributed during the current year and previous year. The TRD filed a petition for a writ of certiorari with the New Mexico Supreme Court. The petition was initially denied, but then the court granted a motion for reconsideration. Secretary Padilla said the New Mexico Supreme Court subsequently declined to make a decision on that matter due to the passage of House Bill 581 and Senate Bill 669 during the 2015 legislative session.

Secretary Padilla said that the TRD is in the process of implementing the new provisions of the law. Specifically, she said the TRD is working with stakeholders on a revised report of monthly distributions, commenting that the report should be easier to read and understand. She stated that a couple of small municipalities have recently been informed of negative distributions and the TRD has contacted those municipalities about the possibility of entering into payment plans with the TRD. Local governments are becoming increasingly vigilant in spotting sudden large increases or drops in gross receipts tax revenues, and as a result, some issues with the use of incorrect location codes have been addressed. The TRD is educating small communities about the importance of tracking spikes or drops in monthly gross receipts tax distributions.

Bill Fulginiti, executive director, New Mexico Municipal League (NMML), said that the NMML is aware of some negative distributions affecting five local governments and the NMML has requested information from the TRD on those negative distributions. The NMML is researching whether the law is being followed with respect to those negative distributions.

Brad Odell, chief legal counsel, TRD, presented a diagram showing the process that the TRD follows with respect to negative distributions to local governments pursuant to the provisions of the new law. He added that the TRD has always worked with local governments and is reaching out to certain communities to enter into payment agreements.

Mr. Fulginiti indicated that in one case, the NMML was under the impression that receipts would be distributed to a local government, but the distribution did not occur. Mr. Odell replied that the relief provisions of House Bill 581 were not triggered in that case. Secretary Padilla said that the TRD would look forward to continuing to work through any issues involving negative distributions because they present difficulties for both local governments and the general fund.

In response to a question from a committee member, Mr. Fulginiti indicated that the NMML is looking into whether there is any possible recovery with respect to the five local governments with negative distributions, which he mentioned earlier. A committee member asked about the potential liability to the state, and Mr. Odell stated that the TRD is analyzing the relevant events and whether there would be any liability to the general fund. He said that, in the process, the TRD is complying with requests for records as required by law. Mr. Fulginiti reiterated that at this point, it is difficult to tell what any potential liabilities would be or what kind of relief municipalities might seek. Secretary Padilla stated that if the general fund was required to absorb negative distributions as contemplated by the New Mexico Court of Appeals decision, the fiscal impact could approximate $85 million. Mr. Fulginiti said that municipalities pay $30 million per year to administer local option gross receipts taxes and that money might go to the general fund. Secretary Padilla said that from the TRD's perspective, the provisions of the new law are working as planned, but the law has been in effect for only one distribution cycle.

A committee member asked whether the TRD and the NMML have examined the root causes of the issues underlying negative distributions in order to prevent future problems. Secretary Padilla stated that the TRD is exploring coding options that might prevent future issues. Frank Crociata, tax policy director, TRD, said that the TRD is exploring an option to use geographical information system components to identify accurate location codes for taxpayers. He added that accurate taxpayer reporting cannot, however, be guaranteed. Secretary Padilla stated that obtaining accurate location codes for construction businesses might present some challenges, since location codes for construction businesses are not based on office locations, but are instead based on construction sites.

New Mexico Municipal League Priorities

Mr. Fulginiti listed the priorities set by the NMML's board of directors. He stated that the NMML supports amendments to provide an additional distribution to municipalities when the local option hold harmless gross receipts taxes do not generate enough revenue to equal their hold harmless distributions.

Another priority of the NMML is the establishment of a local government unit within the TRD to handle administration and distribution issues affecting cities and counties. The unit would be funded with an existing administrative fee paid by local governments and is imposed on 3% of gross receipts taxes collected for local governments.

Mr. Fulginiti said that the NMML also supports an increase in funding for municipal streets, roads and bridges. Municipalities receive a distribution of two cents of the gasoline tax, but funding for those municipal purposes has not increased in almost 30 years. The NMML is seeking either an increase in the municipal share of the gasoline tax or the authority to levy a local option gasoline and special fuels tax.

The NMML also supports an increase in funding for law enforcement from the Law Enforcement Protection Fund, which receives money from an existing insurance premium tax. Mr. Fulginiti said the fund has not received an increase in funding for 15 years.

Mr. Fulginiti also stated that municipalities are experiencing personnel shortages in the areas of law enforcement, fire service, emergency medical services, water and wastewater operations, certified electric utility services and corrections. The NMML supports legislation to provide return-to-work provisions for workers in those areas.

In addition, the NMML supports the continuation of the current distribution of state-shared revenues, including a percentage of the revenues from the state gross receipts tax. The NMML also supports the continued authority to impose local option taxes. Finally, Mr. Fulginiti stated that the NMML continues to support the passage of a general obligation bond for the funding of libraries.

A committee member asked whether the NMML would support an examination of possible revenue shortfalls in state revenue if supplemental hold harmless distributions are provided to municipalities. Mr. Fulginiti said that such an examination would be supported. The committee member asked whether the Public Employees Retirement Association (PERA) might oppose the NMML's return-to-work proposals, and in response, Mr. Fulginiti said that the provisions would not add liability to the PERA system. Another committee member indicated that law enforcement shortages are occurring not only for local governments, but also exist at the state level. The committee member asked whether the NMML would seek the PERA's endorsement of its return-to-work proposals. Mr. Fulginiti responded that the NMML would hire an actuary to review the NMML's assumptions and it is hopeful that it can reach an understanding with the PERA.

A committee member cited instances in which some government workers are retiring at young ages and suggested that modification of retirement ages should be explored. The committee member asked whether the NMML is examining retirement ages in an environment where individuals have longer careers. Mr. Fulginiti said that raising the length of service required for law enforcement officers to retire from 20 years to 25 years might provide some benefit.

A committee member asked whether an existing local option fuel tax exists. Jim O'Neill, consultant, stated that there is such a tax established in law to permit a referendum on a local fuel tax, but the law does not provide for state administration of the tax. Thus, the tax has not been imposed.

A committee member indicated that consumption of gasoline has not increased in the last few years and the reduced consumption could reduce gasoline tax revenues. Mr. Fulginiti stated that fuel tax distributions to municipalities have declined and suggested that indexing mechanisms might provide some solution. He added that municipalities are using general fund revenues and revenue bonds to offset reduced fuel tax collections.

Unemployment Insurance Benefits and Employer Costs

Celina Bussey, secretary, Workforce Solutions Department (WSD), provided the committee with various statistics pertaining to unemployment insurance in the state. She said that the statewide unemployment rate for August 2015 was 6.7% and that 12,000 individuals are currently certifying for benefits every week in New Mexico. In addition, approximately 1,000 initial claims for unemployment insurance are filed every week and as of the date of her presentation, 37,667 experience-rated employers were active. The state's unemployment trust fund balance as of September 15, 2015 was almost $222 million, and the secretary presented a chart showing the monthly balances of the fund from January 2008 through August 2015. In 2012, the balance dropped to a low of about $20 million, but balances began to recover in 2015.

Secretary Bussey also provided some information comparing New Mexico's unemployment insurance system to systems of other states in the region. New Mexico provides for a maximum of 26 weeks of unemployment insurance benefits, which is comparable to states such as California, Nevada, Utah, Colorado, Arizona and Texas. In regard to maximum and minimum benefit amounts, New Mexico has a minimum amount of $77.00 and a maximum amount of $412. Unemployment insurance benefits are based on a replacement percentage of earnings, and in New Mexico, that percentage is 53.5%. In New Mexico, benefits are paid for an average of 18.3 weeks, and the average weekly benefit amount for the first quarter of 2015 was $306.86 and the "exhaustion rate" was almost 43%. The exhaustion rate specifies the percentage of individuals who exhaust all 26 weeks of unemployment benefits.

Secretary Bussey discussed some basic concepts underlying unemployment insurance issues. She said that the term "taxable wage base" refers to the annual amount of wages paid by an employer to an employee that is subject to state unemployment insurance taxes. The taxable wage base fluctuates each year and is set by a formula. In 2015, employers will pay their unemployment insurance tax rate on the first $23,400 of each employee's salary. Secretary Bussey indicated that the amount of each employee's salary that exceeds $23,400 is reported, but not taxed. The amount upon which the unemployment insurance tax is paid is indexed and recalculated each year.

Secretary Bussey explained how different rate schedules applied to employers with various experience ratings over the past few years. Benefit ratios are calculated under a new rating system, and beginning in 2015, new contributing employers will have a rate that is the greater of their industry average unemployment insurance contribution rate or 1%. She added that 61% of businesses were shielded from drastic tax rate changes that would have taken effect under the old formula. A table showing the percentages of employers required to pay various tax rates was presented, and the secretary added that the WSD has worked to educate employers about the manner in which tax rates are calculated and that rate notices will be provided to employers in November.

Secretary Bussey also provided the committee with a chart showing the distribution of unemployment insurance tax payments by various industries. According to a preliminary analysis, overall industry rates are expected to fall in 2016 from the preceding year. However, the tax rate change for industries related to mining, quarrying and oil and gas extraction is expected to rise by 11%. Secretary Bussey further described how tax rate changes might affect employers with various numbers of employees. For instance, employers with up to four employees are expected to experience a 9% reduction, while employers with 500 or more employees are expected to experience a 5% reduction. Several examples were shown of how contribution rates would be calculated under the new rating system.

Secretary Bussey also explained how the "60 percent rule" is used to calculate maximum benefits for eligible individuals. Total benefit amounts are based on the lesser of 60% of an individual's wages for insured work paid during the individual's base period or the weekly benefit amount multiplied by 26 weeks. Some individuals might have only a marginal attachment to the workforce, but still receive more generous benefit amounts than those available in other states. She indicated that such circumstances might exist in construction and agricultural industry sectors.

Questions from committee members followed. A committee member asked about policies that other states have employed to encourage reemployment or strategies that have been used with respect to benefit amount adjustments. Secretary Bussey responded that some states have strived to provide lower benefit amounts, to reduce exhaustion rates or to provide more targeted reemployment strategies. The committee member asked what specific reemployment strategies could be employed in New Mexico. Secretary Bussey replied that it is important to go back to basics and understand barriers that unemployed individuals might face in becoming reemployed. The committee member and Secretary Bussey discussed the roles that chambers of commerce, private companies and local workforce boards could have in reemployment efforts.

Another committee member commented that the state should seek strategies to foster the extension of employment periods for industries that are typically classified as seasonal industries. The committee member stated that, for example, there might be possibilities for some agricultural businesses to extend processing periods for certain crops on a year-round basis. Another committee member expressed concern about rising unemployment rates in the oil and gas industry, and the secretary added that the industry has experienced an increase in its unemployment insurance tax rate.

A committee member inquired whether there is a target balance for the unemployment trust fund. Secretary Bussey explained that a target balance requires the provision of an adequate reserve. A fund balance that provides enough money to pay for benefits for the next 12 months is adequate, but the WSD is now looking to keep enough cash on hand for the next 18 to 24 months while considering payouts for the five years in which the highest payouts were made. Considering such factors, an ideal unemployment trust fund balance is about $400 million. A committee member asked a follow-up question about the role of a reserve factor in calculating the balance. Secretary Bussey responded that reaching a target balance is a goal, but also indicated that overfunding could lead to discounted rates for employers.

A committee member asked how the WSD might combat abuse of unemployment benefit claims. Secretary Bussey replied that the WSD is conducting follow-up work on claims through audits and by encouraging unemployed individuals to actively seek employment on a weekly basis. She also discussed the importance of employer vigilance and education of employers. Another committee member talked about the importance of the availability of unemployment benefits during economic downturns, but stated that abuses of unemployment benefits also present a challenge.

<u>Wednesday, October 14</u>

Approval of Minutes

On a motion made and seconded, the minutes from the August meeting, with a technical correction, were adopted without objection. On a motion made and seconded, the minutes from the September meeting were adopted without objection.

Update of Growth of the Craft Beer Industry in New Mexico

Christopher Goblet, director, New Mexico Brewers Guild (NMBG), and Berkeley Merchant, board member, NMBG, provided the committee with a presentation on the status of the craft beer industry in New Mexico. Mr. Goblet indicated that the industry for brewing craft beer is the fastest-growing manufacturing sector in the state and that the industry's growth has favorably impacted tourism. He pointed out that craft businesses will increase from 23 in 2013 to 72 in 2018 and business locations will increase during the same period from 33 locations to 86 locations. Capacity for breweries has grown by 157% from 2013 to 2015, and brewery expansions in 2015 exceeded $14 million in capital investment. Breweries are increasingly expanding into both the rural and urban areas of the state. Examples of various brewery expansions include areas such as Silver City, Moriarty, Taos, Santa Fe, Albuquerque and Las Cruces.

Mr. Goblet stated that brewery expansions have contributed to economic development and have led to job development and capital expansion in various locations. Some communities are leveraging craft breweries to create rural festivals to attract tourists. Industry participants are also exploring means to expand agricultural opportunities through the cultivation and processing of barley and hops. In addition, educational institutions such as Central New Mexico Community College and the University of New Mexico are building educational facilities and designing classes focused on brewery science and operations.

Mr. Merchant said that craft beer businesses account for 15% of the market share in the United States, but New Mexico lags in market share growth and per capita consumption. He said that craft beer business participants are increasingly exploring opportunities to permit those businesses to serve as economic engines in the state. He mentioned that the craft beer industry has faced some challenges in reaching production levels to achieve economies of scale within the state's tax structure.

Mr. Merchant stated that breweries in New Mexico constitute either brewpubs that only sell their products in New Mexico or packaging breweries that sell products in the state and out of the state. Microbrewers are subject to lower liquor excise tax rates than other beer brewers. In addition, the liquor excise tax is applied only to beer produced and sold in New Mexico. He explained that beer produced in New Mexico and shipped out of state is not subject to the liquor excise tax, but is subject to the applicable excise tax imposed by the destination state.

Mr. Merchant explained that the NMBG's priority for the 2016 session would include possible changes to the definition of "microbrewer" in the Liquor Control Act. Before 2014, a brewery that produced less than 5,000 barrels per year constituted a microbrewery. A microbrewery producing less than 5,000 barrels per year was taxed at a rate of eight cents per gallon, while a brewer producing more than 5,000 barrels was taxed at a rate of 41 cents per gallon. He said that breweries often controlled production to avoid the higher tax rate.

Mr. Merchant said that in 2014, the law changed so that breweries producing less than 15,000 barrels per year would constitute microbreweries. The tax structure also changed so that the first 10,000 barrels sold by a microbrewer is taxed at a rate of eight cents per gallon, while a tax rate of 28 cents per gallon is imposed on production exceeding 10,000 barrels but remaining less than 15,000 barrels. Brewers producing 15,000 or more barrels are taxed at a rate of 41 cents per gallon. Mr. Merchant noted that in 2023, the definition of "microbrewer" will again only encompass breweries producing less than 5,000 barrels per year. He said the restoration of the previous definition might create uncertainty and the NMBG recommends keeping the current definition of "microbrewer" in place.

Mr. Merchant noted that excise tax revenues attributable to breweries have grown. In 2007, $41,775 in liquor excise tax revenues was attributable to breweries. The revenues grew to $84,174 in 2013 and $155,846 in 2014. Mr. Merchant said liquor excise tax revenues attributable to breweries are expected to approximate $185,000 for 2015.

Some committee members expressed concern with removing the time limitation on the existing definition of "microbrewery" within only a couple of years of the change to the law in 2014. They discussed how the time limitation set for 2023 provides a period during which sufficient data on tax collections pursuant to the existing law can be gathered. They suggested that the time limitation be evaluated closer to its expiration in 2023.

A committee member asked whether the change to the definition of "microbrewer" and the amended liquor excise tax structure have helped to grow the economy. Mr. Goblet indicated that the NMBG is beginning to collect data pertaining to any correlation between the change in the law and economic growth, but it is expected that the change will encourage production.

A committee member asked what might constitute a fair tax rate if the existing tiered structure, based on production, for the imposition of liquor excise taxes was eliminated. Another committee member asked how New Mexico's liquor excise tax rate compares to that of other states. Mr. Merchant indicated that the median rate across all states is about nine cents per gallon. He indicated a fair rate could exist within that range and that a flat rate should be predictable and equitable.

A committee member discussed some policy concerns with providing lower rates for microbreweries. The committee member indicated that microbrewery growth might cause increased alcohol consumption. The committee member suggested that improved enforcement of laws governing liquor production, distribution and consumption might merit consideration. Another committee member discussed the relationship between alcohol consumption and incidents of domestic violence and driving while intoxicated. A committee member commented that some revenues from the liquor excise tax are distributed to the Local DWI Grant Fund.

In response to a question from a committee member, Mr. Merchant indicated that microbreweries carry insurance in the same manner as other purveyors of liquor. Mr. Merchant and the committee member discussed whether state laws limit the alcohol content of beer produced in the state. Staff was requested to research alcohol limits for wine, beer and other alcoholic beverages.

Determining In-State Sales of Intangibles and Services

Richard Anklam, president and executive director, New Mexico Tax Research Institute (NMTRI), listed the principles that the NMTRI has identified as principles of good tax policy. The principles include adequacy, efficiency, equity, simplicity, comprehensiveness and accountability.

Mr. Anklam stated that multistate business income must be "fairly apportioned" to be constitutional. For instance, New Mexico can only tax income amounts attributable to activities in the state. Mr. Anklam noted, however, that state apportionment rules can vary. Yet, if other states impose the same rules, they cannot tax the same income.

Mr. Anklam described the Uniform Division of Income for Tax Purposes Act (UDITPA). He said it was codified by most states with income taxes resulting in somewhat consistent rules, including rules for apportionment of business income. The UDITPA included a traditional three-factor formula for business income apportionment, with factors including property, payroll and sales. Under a formula in which each factor accounted for one-third of the apportionment formula, two-thirds of the factors were centered on activities in the state where production occurred, while one-third of the factors were centered on activities in the states in which the products of the businesses were marketed.

Mr. Anklam said that a single apportionment formula is not necessarily appropriate in all situations. Thus, the UDITPA provides discretion to taxing agencies to use different allocation or apportionment methods to more fairly represent business activities in the state.

Mr. Anklam described previous income sourcing rules under the UDITPA. Under the previous provisions, sales, other than sales of tangible personal property, were considered to be in the state if: (1) the income-producing activity was performed in the state; or (2) the income-producing activity was performed both inside and outside the state, but a greater proportion of the income-producing activity was performed inside the state, based on the cost of performance.

Under the new UDITPA rules, Mr. Anklam stated that receipts, other than receipts in Section 16 of the UDITPA, are in the state if the taxpayer's market for sales is in the state. When services are sold, the income is considered to be in the state to the extent the service is delivered in the state.

Mr. Anklam stated that it is not always clear where intangible property is ultimately used. Thus, the UDITPA includes a new approach with respect to sourcing intangible property by specifying that intangible property is used in a state if it is purchased by a consumer in the state. Mr. Anklam also indicated that current rules center less on the cost of performance. Pursuant to the new provisions, a contract right, government license or similar intangible property authorizing the holder to conduct a business activity in a specific geographic area is used in a state if the geographic area includes all or part of the state. In addition, receipts from intangible property sales contingent on the productivity, use or disposition of the intangible property are treated as receipts from the rental, lease or licensing of intangibles. All other receipts from the sale of intangible property are excluded.

A committee member and Mr. Anklam discussed the differences between income apportionment rules that are based on the cost of performance versus sales. Mr. Anklam said that Section 18 of the UDITPA provides some additional flexibility to allow states to fairly apportion business income. Another committee member asked whether the use of a single-sales factor in a state would require the use of market-based sourcing. Mr. Anklam replied that if a mandatory sales factor is implemented in the state, movement toward market-based sourcing could be considered. Use of a single-sales factor or market-based sourcing might be considered independently or together.

Update on County Gross Receipts Taxes

Steve Kopelman, executive director, New Mexico Association of Counties (NMAC), provided the committee with an overview of gross receipts tax collections by the state's counties. He stated that gross receipts taxes have become more important in the counties because property tax revenues have been flat for a long period of time. Mr. Kopelman presented a chart showing the extent to which the counties are imposing 18 local option gross receipts taxes, including 12 that require voter approval.

Mr. Kopelman highlighted various taxes that a few counties have imposed. He noted that no counties have imposed the quality of life gross receipts tax. In addition, few counties are authorized to impose the regional spaceport gross receipts tax, and only two counties have imposed a one-twelfth general gross receipts tax increment for the Safety Net Care Pool Fund. Some local option gross receipts taxes are unused or unusable because the laws permitting their imposition are narrowly drawn.

Mr. Kopelman stated that the NMAC supports gross receipts tax reform and restructuring. In particular, the NMAC proposes eliminating local option taxes that are not used and replacing those taxes with general purpose increments. He said the counties would like to partner with the state in fostering a more competitive gross receipts tax structure.

Mr. Kopelman discussed the effects of phased-out eliminations of hold harmless payments to counties and the authorization to counties to impose a replacement gross receipts tax. As of July 2015, 19 out of 30 counties have accordingly enacted one-eighth percent gross receipts tax increments.

Mr. Kopelman stated that county commissions have voted to impose additional gross receipts tax increments largely because of costs associated with county detention centers. He explained that if inmates have sentences of less than one year, they are automatically incarcerated in county jails, but that some inmates might be held for up to four years before a trial is provided. Mr. Kopelman added that inmate mental illness issues also increase the costs of operating county jails. He said that probation violations present another issue driving up the costs of jail operations.

Rick Rudometkin, county manager, Eddy County, said that Eddy County's detention facilities are overcrowded. For example, one specific facility is currently holding 300 inmates, but it was intended to hold only 250 inmates. Mr. Rudometkin also discussed the difficulties in recruiting qualified officers at the county's detention facilities.

Mr. Rudometkin also stated that counties in southeastern New Mexico benefit from oil and gas production, but such production also results in issues such as deteriorated roads and overpopulation. However, since oil and gas prices have dropped, there has been a reduction in population inflows from other states. He also discussed other problems encountered by Eddy County, including floods.

Mr. Rudometkin stated that the Eddy County Board of County Commissioners explored a proposal to impose all three one-eighth percent gross receipts tax increments that counties are permitted to impose to replace hold harmless payments, but due to some opposition, only a single one-eighth percent increment increase will take effect, beginning in January. He said such tax increases have become necessary for counties to meet expenses for jails, roads, infrastructure and other requirements. Mr. Rudometkin said that the availability of alternative sources of revenue is becoming increasingly critical for counties.

A committee member asked whether the NMAC will seek the proposal of legislation to provide for additional taxing authority for counties. Mr. Kopelman responded that the NMAC is not proposing any tax increase, but is seeking to work with courts on practical issues pertaining to bail bonds and probation, in order to help alleviate overcrowding at county detention facilities.

Another committee member expressed concern about the use of gross receipts tax increments, intended to replace hold harmless payments, for other purposes voters had previously rejected. Mr. Kopelman suggested that the elimination of earmarks from county gross receipts taxes would provide boards of county commissioners with more flexibility to meet expenses. He noted that if the boards use their taxing authority in a manner that does not reflect the desires of the voters, they would ultimately still be accountable to the voters. Mr. Rudometkin added that county managers must provide boards of county commissioners with all of the options that are available to solve certain problems. A committee member raised the possibility of using some motor vehicle excise tax revenues for local roads.

A committee member inquired about the history of the quality of life gross receipts tax. Mr. O'Neill explained that the tax was initially established to encourage the development of art facilities and museums and that individuals from the arts community are required to have a role in the proposed imposition of a quality of life gross receipts tax.

A committee member expressed a desire to find more systematic changes to address revenue shortfalls in counties and indicated that some states have established funding formulas for local governments. The committee member pointed out that the state has taken on a stronger commitment to provide capital funding for schools. The committee member also said that some states have used general fund revenues for roads at the expense of other necessary programs. The committee member indicated that county commissioners might need to work with county treasurers and that their relative requirements and responsibilities would need to be considered when making spending decisions.

In response to a question from a committee member, Mr. Rudometkin stated that Eddy County is exploring options to provide funding to address issues stemming from a sinkhole existing in the county. The committee member suggested that since severance tax bonding capacity is expected to be fairly low for the upcoming session, the county might consider options for funding the project at the county level.

Committee members discussed issues raised regarding county detention facility overcrowding. A committee member mentioned that the underlying issues leading to overcrowding should be addressed. Another committee member acknowledged the challenge of providing for adequate public safety, while alleviating the pressures on county budgets. The committee member mentioned that the New Mexico Supreme Court has convened an ad hoc task force to explore underlying issues related to bonding, which might contribute to overcrowding at county detention facilities. Another committee member raised a concern about the costs that counties bear with respect to mental health issues arising in county detention facilities. The committee member suggested that laws requiring counties to field all county jail costs should be reviewed. The committee member also suggested that the removal of earmarks on county-imposed gross receipts taxes should be explored.

Adjournment

There being no further business before the committee, it adjourned at 12:15 p.m.